

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Acting Chairman;
Tony Hammond, Vice Chairman;
Mark Acton;
Ruth Y. Goldway; and
Nanci E. Langley

Periodic Reporting
(Proposal Eleven)

Docket No. RM2015-4

ORDER APPROVING ANALYTICAL PRINCIPLE
USED IN PERIODIC REPORTING
(PROPOSAL ELEVEN)

(Issued February 9, 2015)

I. INTRODUCTION

This Order addresses a Postal Service petition filed pursuant to 39 C.F.R. § 3050.11 seeking approval of Proposal Eleven, Change in the Attribution of Debit and Credit Card Fees.¹ For the reasons discussed below, the Commission approves Proposal Eleven.

The remainder of this Order provides background information; describes Proposal Eleven; addresses related filings; and presents the Commission's analysis and conclusion. A procedural summary appears in the Appendix.

¹ Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Eleven), November 4, 2014 (Petition).

II. BACKGROUND

Proposal Eleven concerns a change in the distribution key for allocating credit and debit card fees to products.² It stems from a review the Postal Service conducted after observing increases in customers' use of debit and credit cards to purchase postal products and services and increases in the usage fees the Postal Service pays to banks for facilitating these purchases. Petition, Attachment at 1. As a result of this review, the Postal Service concluded that the incurrence of a usage fee is associated with the revenue generated by the transaction paid for with a credit or debit card. *Id.*

III. PROPOSAL ELEVEN: CHANGE IN THE ATTRIBUTION OF DEBIT AND CREDIT CARD FEES

A. Postal Service Proposal

Summary. Proposal Eleven redefines the methodology for determining the attributable costs of usage fees and allocating these costs to products. *Id.* Under the proposed change, usage fees would be considered variable with the applicable product revenue. *Id.* Attachment at 2.

Rationale. The Postal Service asserts that the current methodology's reliance on volume variability (in terms of window transactions) does not reflect the actual incurrence of usage fees; instead, it maintains that usage fees are precipitated by the revenue from the products purchased with credit and debit cards. *Id.* at 2. More specifically, the Postal Service contends that usage fees are mainly a predetermined percentage of the cards' transaction revenue, and therefore should be fully variable with the applicable revenue. The Postal Service also asserts that the proposed revision will allow it to more accurately assign usage fees to the products that were purchased with credit and debit cards, and thus incurred the fees. *Id.* at 3.

² The banking industry refers to these fees as interchange transaction fees or interchange fees. See 75 FR 81722, n.1, December 28, 2010. Colloquially, these fees are often referred to as swipe fees. In the remainder of this Order, they are referred to as usage fees.

Current methodology. Currently, the Postal Service accounts for usage fees within two General Ledger (G/L) accounts. *Id.* at 2. Pursuant to this practice, the bulk of the \$200 million in Fiscal Year (FY) 2013 fees (\$171.7 million) was recorded in G/L account 52426, *Credit and Debit Card Services*, and included in cost component 126 in Cost Segment 13, Miscellaneous Operating Costs. These costs were then allocated to products based on Cost Segment 3 window service clerk direct labor costs, which are approximately 39 percent variable with volume.³ Petition, Attachment at 2. The remaining costs (\$28.3 million) were recorded in G/L account 52359, *Professional and Other Miscellaneous Services*, which is one of several G/L accounts included in cost component 177 in Cost Segment 16, Supplies & Services. *Id.* Some of the costs in this cost component were allocated to products and services on the basis of total postal labor costs.⁴

The two G/L accounts, in combination, resulted in an overall average variability of approximately 42 percent for the \$200 million in FY 2013 usage fees. Petition, Attachment at 2. The remaining 58 percent was classified as institutional costs, and not allocated to any products. *Id.*

Proposed methodology. The Postal Service proposes defining usage fees as fully variable with the applicable transaction revenue. *Id.* To implement this approach, the Postal Service proposes developing a distribution key using the total revenue from purchases made with debit or credit cards. *Id.* Each year, payment tender reports for revenue by product will be developed from each of the major revenue reporting systems.⁵ Petition, Attachment at 2. The revenues from these sources will be

³ Summary Description of USPS Costs by Segment and Component FY 2013, July 1, 2014, at 13-3 (Summary Description). The causal link for variability is the time a clerk spends swiping the card and obtaining a customer's signature.

⁴ Summary Description at 16-4 through 16-5.

⁵ The revenue reporting systems are Point of Service One, Retail Data Mart, National Customer Management System, and the Address Management System. See Responses of the United States Postal Service to Questions 1–5 of Chairman's Information Request No. 1, November 24, 2014, question 2.

combined and grouped by product. *Id.* Each product's percentage of total revenue generated by payments made with credit and debit cards will be calculated, and the resulting percentage will serve as the distribution of usage fee to the respective products. *Id.* The distribution key will be recalculated each year, and any new payment systems the Postal Service institutes will be included in the development of the distribution key. *Id.* at 2-3. In addition, all usage fees, which are currently split between Cost Segments 13 and 16, will be assigned only to Cost Segment 13. *Id.* at 3.

Impact. The current methodology, applied to FY 2013 data, allocates approximately \$83.3 million of \$200 million in total usage fees. *Id.* at 3. Using the same cost data, the proposed methodology allocates approximately \$196.9 million in usage fees, an increase of over \$113 million. *Id.* The remaining \$3.1 million is classified as institutional.⁶ *Id.* The proposal's impact on individual products and services varies in terms of cost allocation: there are increases, decreases, and, in some instances, no allocation. *Id.* at 6-7.

The Postal Service provides a comparison of the distribution keys for the current and proposed methodologies and a comparison of the costs that are allocated to products and services. *Id.* at 4-7. In addition, the Postal Service provides similar tables under seal (as Library Reference USPS-RM2015-4/NP1) showing the effect of Proposal Eleven on competitive products.

⁶ The \$3.1 million includes, among other costs, the costs associated with non-postal products, agency-assisted and philatelic purchases, and costs not specifically related to any postal product. Petition, Attachment at 3.

B. Comments

The Greeting Card Association (GCA) and the Public Representative filed initial comments. See Initial Comments of the Greeting Card Association, December 3, 2014, (GCA Comments) and Initial Comments of the Public Representative on Proposal Eleven, December 3, 2014 (PR Comments). The Postal Service filed reply comments. See Reply Comments of the United States Postal Service, December 4, 2014 (Postal Service Reply Comments). No additional comments were received.

1. Public Representative

Summary of position. The Public Representative recommends approval of Proposal Eleven, but suggests that the Commission study the impact of the proposal on pricing. PR Comments at 4.

Reasons for support. Based on his review of the filings in this docket, the Public Representative concludes that the proposed methodology is more accurate and more appropriate than the current methodology. *Id.* at 1. With respect to accuracy, he states that the products incurring usage fees will bear the costs attributed to those fees. *Id.* at 4. He considers this "consistent with 39 U.S.C. 3622(c)(2), which requires 'that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships....'" *Id.* With respect to appropriateness, the Public Representative states that the proposal significantly reduces the percentage of usage fees classified as institutional costs. *Id.* at 4-5. He observes that if the Postal Service had applied Proposal Eleven in FY 2013, the percentage of usage fees classified as institutional would have "notably decreased from approximately 58 percent to approximately 1.6 percent." *Id.* at 5. He considers this reduction appropriate because it "shifts the costs associated with usage fees away from mail users generally and towards users of those products that incurred those fees." *Id.*

Additional analysis. The Public Representative also presents three tables highlighting the proposal's impact on products and services. Table 1 compares allocation of usage fees to products under the current and proposed methodologies. *Id.* at 4. Table 2 compares actual and proposed usage fee allocations using FY 2013 data, along with corresponding fee increases. *Id.* at 5. Table 3 identifies the products that would experience cost decreases of more than \$1 million due to Proposal Eleven. *Id.* at 6.

The Public Representative notes there are some significant increases and decreases in allocations to certain products under the proposal, and that allocations to some products are eliminated.⁷ *Id.* He further observes that the Postal Service does not mention the effects of the proposed methodology on product pricing. *Id.* He recommends the Commission consider the impact the change will have on specific product pricing. *Id.*

2. Greeting Card Association

Summary of position. The Greeting Card Association (GCA) asserts that Proposal Eleven raises questions of attributable cost theory, and therefore cautions that if the Commission approves the proposal, the costing approach it reflects should not become a broad precedent. GCA Comments at 2.

Reasons for position. GCA's position is based on its observation that because the proposal allocates usage fees on the basis of transaction revenues, the level of cost attributed to a given product depends in material part on its price, which is the institutional cost burden (markup) it carries as a result of previous ratemaking decisions. *Id.* GCA presents a hypothetical example illustrating that a product with the same unit attributable cost as another, but a higher markup, would be assessed a larger transaction fee simply because of the higher markup. *Id.* GCA concludes: "In other

⁷ The market dominant products are First-Class Single-Piece Letters, First-Class Mail Parcels, Package Services Single-Piece Parcel Post; Package Services Media and Library Mail; and Special Services Post Office Box Service. *Id.*

words: more cost would be attributed to product B because a previous decision assigned it a greater per-piece burden of institutional cost." *Id.* at 2-3. It contends that a causal relationship — the necessary basis for cost attribution under the statute — thus depends on a *non-causal* allocation of costs for which no causal relationship has been established. *Id.* at 3. (Emphasis in original.)

While GCA acknowledges that the relationship between usage fees and the sale of the products that generates these fees could be characterized as "causal," it concludes that the Postal Service's description of the data systems available and the way in which they would be used could also turn out to be "reliably identified." *Id.* It emphasizes that the amount of the usage fee can be significant due to the non-causal institutional cost borne by the product, adding:

The difficulty is simply that the swipe fee is what it is, in any given case, in significant part because of the per-piece quantum of "un-caused" institutional cost borne by the product concerned. This fact, in GCA's view, calls into question the Service's view that per-transaction revenue is an unproblematic basis for drawing a causal relationship between swipe fees and the attributable cost of a product.

Id.

Thus, GCA cautions that if the Commission were inclined to approve Proposal Eleven, it must do so carefully and recognize the anomaly of basing the attribution of the credit and debit card fees on previous pricing decisions that distributed institutional costs to the products. *Id.* GCA further maintains that the "exceptional circumstances" of this proposal should not become a broad precedent in determining attribution of costs to products. *Id.*

C. Reply Comments

Summary of position. The Postal Service disagrees with GCA's interpretation of the costing theory for Proposal Eleven. Postal Service Reply Comments at 1. It also

expresses reservations about the Public Representative's suggestions that the Commission address the proposal's impact on pricing. *Id.* at 2.

Reasons for position. The Postal Service notes that GCA's concern is based on the idea that if the rates of postage for various postal products were different, the relevant accrued costs would also be different. *Id.* at 1. It concedes this could be true at some level, but maintains it is of limited value in costing. Therefore, the Postal Service considers GCA's reservations about the proposal misplaced. *Id.* at 2.

The Postal Service notes that the Public Representative recommends approval of the proposal, but expresses reservations about the Public Representative's suggestion that the Commission take into account the proposal's effect on product pricing and, for competitive products, compliance with the attributable cost floor requirement. *Id.* The Postal Service states that while the Public Representative's suggestion is not unreasonable, it has concerns about its implications. *Id.* The Postal Service notes that the proposal should be judged entirely on the improvements in the accuracy of costing. It asserts that the primary objective is to estimate product costs in the most accurate way possible, and maintains that any pricing implications should be addressed in the pricing process. *Id.* at 2-3. It emphasizes that pricing implications should not impede the pursuit of the best costing methodologies. *Id.* at 3.

IV. COMMISSION ANALYSIS

Summary. The Commission approves Proposal Eleven because it better reflects cost incurrence. At the same time, the "costs" that usage fees represent are atypical in that they are based on transaction revenue. The Commission therefore considers the Proposal Eleven approach of limited precedential value.⁸

⁸ The Commission notes that there is one other instance (outside of negotiated service agreements) in which revenues are used as a distribution key to allocate variable costs to the products: Postmaster variable costs are allocated to products using revenues from the Revenue, Piece, and Weight report. Summary Description at 1-2.

Proposal's consistency with section 3622(c)(2). GCA claims that the proposed distribution key for allocating usage fees to products is not based on a true causal relationship as required under 39 U.S.C. 3622(c)(2). Using a hypothetical transaction, GCA notes that if two products are purchased that have identical unit attributable costs but different markups, the product with the higher markup (and presumably a higher rate) would be charged a higher usage fee than the lower rated product. GCA Comments at 2.

The Postal Service remarks that while this hypothetical is true at some level, it is of limited value in costing. Postal Service Reply Comments at 1. It maintains that the additional cost caused by the higher rated product is the cost incurred and is the only causal relationship that is relevant. *Id.*

The Postal Service's position is that revenues associated with credit and debit card transactions "cause" the occurrence of the usage fees, so these revenue are an appropriate proxy for volume as a cost allocation method. GCA's position stems from de-composing the revenue figure into costs and a markup over costs, and observing that products with a higher markup cause a bias in the allocation of the costs to those products.

The Commission finds that attributing usage fees to products based on transaction revenue from purchases paid for with credit and debit cards is preferable to attributing these costs based on window service distributions or total postal labor because it better aligns distribution of costs with the incursion of those costs. In addition, reallocating the fees currently included in Cost Segment 16 to Cost Segment 13 as a separate component improves the transparency of the total costs of credit and debit card transactions because these costs will no longer be grouped with other non-related contractual postal costs. It also improves the analysis of cost causation and the development of the proper allocation of costs to the products. Together, these changes represent an improvement over the current methodology.

At the same time, the Commission finds, based on the explanation in the Postal Service's Petition, that it is the transaction, not the value of the transaction, which

causes a fee to be incurred, while the total value of the transaction determines the amount of the fee. Without the transaction, there is no fee. Therefore, an appropriate refinement is to use the ratio of credit and debit card transactions to the total number of transactions to determine the variability of usage fees. If data on the number of transactions involving postal products and services using credit and debit cards can be isolated from other types of payment forms (such as cash and prepayment accounts) in the retail systems, the Postal Service should base the cost allocation on this ratio. If these data are not available, the Postal Service should evaluate this methodology further to determine if the transactional data can be delineated. In the meantime, the Commission approves the proposed methodology.

Proposal's impact on costs and pricing. The Public Representative concludes that Proposal Eleven would not only significantly increase usage fees allocated to three competitive products and five market dominant products, but asserts that these products account for the majority of the shift in fee allocation across the product spectrum. PR Comments at 5. He further observes that the products with the largest increases in attributable costs could incur price increases, or a competitive product could fail to cover its total attributable costs. *Id.* at 6. The Public Representative's tables, based on the Postal Service's filing, highlight the impact of the proposal, and his assessments of the impact on cost allocations are correct.

The Commission appreciates the Public Representative's concern about the impact of Proposal Eleven on pricing, as well as the Postal Service's observation that such considerations are not relevant to improvements in the accuracy of costing. The Commission notes, with respect to the Public Representative's observation that implementation of the proposal could result in an "underwater" product, that a review of the FY 2014 Cost and Revenue Analysis report demonstrates that no product fails to satisfy 39 U.S.C. 3622(c)(2) as a result of the implementation of this proposal.⁹ With respect to the disparate impact on individual mailers, the Commission notes that the

⁹ Docket No. ACR2014, Library Reference USPS-FY14-1, December 29, 2014, at 1-3.

proposal shifts the institutional cost burden on First-Class Mail products as a whole to individual products based on whether the customer uses a credit or debit card to complete a transaction. Allocating costs on this basis is an accepted costing approach.

In conclusion, the Commission approves the Postal Service's proposal to change the distribution key for usage fees.

V. ORDERING PARAGRAPH

It is ordered:

For purposes of periodic reporting to the Commission, the Commission accepts the changes in analytical principles proposed by the Postal Service in Proposal Eleven.

By the Commission.

Shoshana M. Grove
Secretary

PROCEDURAL SUMMARY

On November 4, 2014, the Postal Service filed a petition seeking initiation of a proceeding to consider Proposal Eleven, Change in Attribution of Debit and Credit Card Fees.¹ The Postal Service concurrently filed supporting workpapers and an application for non-public treatment of certain material it considers confidential business information.²

On November 7, 2014, the Commission issued Order No. 2244 establishing the instant docket for consideration of the Petition, designating an officer of the Commission (Public Representative) to represent the interests of the general public, and establishing dates for filing comments and reply comments.³ The Commission later extended the comment deadline.⁴

The Commission issued, and the Postal Service responded to, one information request.⁵

¹ Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Eleven), November 4, 2014 (Petition). The Petition was filed pursuant to 39 C.F.R. § 3050.11.

² See Notice of Filing of USPS-RM2015-4/NP1 and Application for Nonpublic Treatment, November 4, 2014. The Commission received no comments addressing the Application for Non-public Treatment.

³ Notice and Order of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Eleven), November 7, 2014 (Order No. 2244).

⁴ Order Extending Deadline for Comments, November 24, 2014. See also Public Representative Motion to Extend Comment Deadlines, November 21, 2014.

⁵ See Chairman's Information Request No. 1, November 20, 2014, and Responses of the United States Postal Service to Questions 1-5 of Chairman's Information Request No. 1, November 24, 2014.

The Public Representative and the Greeting Card Association filed comments on December 3, 2014.⁶ No other initial comments were received. The Postal Service filed reply comments on December 4, 2014.⁷ No additional comments were received.

Following consideration of the Petition and other filings in this docket, the Commission approved Proposal Eleven.

⁶ Initial Comments of the Greeting Card Association, December 3, 2014 and Initial Comments of the Public Representative on Proposal Eleven, December 3, 2014.

⁷ Reply Comments of the United States Postal Service, December 4, 2014.